

General Information Letter: No credit is allowed for repayment of claim-of-right income, but subtraction modification is allowed for amounts used to compute credit under IRC Section 1341.

January 7, 1999

Dear:

This is in response to your letter dated November 18, 1998 in which you request a Private Letter Ruling. Department of Revenue ("Department") regulations require that the Department issue only two types of letter rulings, Private Letter Rulings ("PLRs") and General Information Letters ("GILs"). PLRs are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. GILs do not constitute statements of agency policy that apply, interpret or prescribe the tax laws and are not binding on the Department. For your general information we have enclosed a copy of 2 Ill. Adm. Code Part 1200 regarding rulings and other information issued by the Department.

Although you have not specifically requested either type of ruling, the nature of your question and the information provided require that we respond only with a GIL.

In your letter you stated:

Please accept this letter as a request for a binding ruling with regards to right of claim repayment on a third party insurance taxable payments which were repaid after the tax years in which the payments were received.

Also, please advise as to wheather or not Illinois has a similar tax code to the IRS code IRC 1341 which allows credit for the difference in taxes paid vs amount that would have been paid had the sick pay been repaid in the actual year it was received and taxable.

The individual in question received third party insurance payments in the taxable years 1996 & 1997 but did not repay the amounts until 1998.

This individual's income will only be from a disability pension and therefor will be non-taxable under present Illinois tax code and the binding ruling on possible refund of Illinois Income Tax is crucial to our tax preparation for 1998.

Discussion

I cannot provide you with a binding letter, as Department regulations prevent the issuance of binding letters except through a PLR. To seek a PLR, you must follow the procedures outlined in 2 Ill. Adm. Code 1200 (included).

In the case of an individual, base income means an amount equal to the taxpayer's federal adjusted gross income for the taxable year as modified with subtraction and addition modifications listed in Section 203(a) of the Illinois Income Tax Act. Pursuant to Section 203(h), "except as expressly provided by this Section there shall be no modifications or limitations on the amounts of income, gain,

loss or deduction taken into account in determining gross income, adjusted gross income or taxable income for federal income tax purposes for the taxable year, or in the amount of such items entering into the computation of base income and net income under this Act for such taxable year."

With respect to recalculating Illinois taxable income as a result of repaying a part of a prior year's taxable income, an individual is allowed to modify his or her adjusted gross income with a subtraction "equal to the amount of the deduction used to compute the federal income tax credit for restoration of substantial amounts held under claim of right for the taxable year pursuant to Section 1341 of the Internal Revenue Code." IITA

Section 203(a)(2)(P). For federal purposes, when an item was included in gross income for a prior taxable year (or years) because it appeared that the taxpayer had an unrestricted right to such item, and the amount of such deduction exceeds \$3,000, the taxpayer is entitled to either a deduction or a credit.

For Illinois income tax purposes, only a taxpayer who has taken a federal credit for amounts repaid under "claim of right" is entitled to the subtraction modification. If the taxpayer claims the deduction federally, no Illinois subtraction modification is allowed. Furthermore, if there is insufficient Illinois income available from which to deduct the full amount of the claim of right subtraction modification, the remaining modification amount is forfeited. There is no provision in the Illinois Income Tax Act to allow a carryover of an excess claim of right subtraction amount. Therefore, the only manner in which a taxpayer may "recoup" taxes paid on amounts held under claim of right is in the manner authorized by Section 203(a)(2)(P) of the Illinois Income Tax Act. While this may seem a somewhat harsh result, we are unable to administratively modify the clear terms of the Illinois Income Tax Act.

I hope that this has been helpful to you. If you have additional questions please feel free to contact me at the above address.

Very Truly Yours,

Charles Matoesian
Staff Attorney